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Government of Canada Announces Technical Changes to the Income Tax Treatment of Gains and Losses on Debt Denominated in a Foreign Currency

The Honourable Jim Flaherty, Minister of Finance, today proposed technical changes to extend the application of certain income tax rules that apply to capital gains and losses of a corporation on an acquisition of control to also apply to capital gains and losses on debt denominated in a foreign currency.

Under existing tax rules in the Income Tax Act (or Act), a corporation that undergoes an acquisition of control (for example, when another taxpayer buys all of its shares) is required to recognize, for income tax purposes, all of its accrued capital losses on property that the corporation owns at that time. Those newly-realized capital losses, together with the corporation's other capital losses, cannot be used after the acquisition of control. The corporation can, however, elect to realize any accrued capital gains on other property that the corporation owns, allowing it to use some or all of its capital losses to offset those capital gains.

Unlike other accrued capital gains and losses, capital gains and losses resulting from foreign currency fluctuations on a corporation's debt liabilities have not been subject to these rules, even though in other respects the Act generally treats capital gains and losses realized in respect of foreign currency fluctuations like other capital gains and losses. Under this proposal, the Act would be amended to extend the general treatment of accrued capital gains and losses on an acquisition of control of a corporation to also apply to a corporation's accrued capital gains and capital losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency.

The new rules will generally apply to acquisitions of control that occur after today's date, other than an acquisition of control that occurs before 2009, where the persons acquiring control are obligated to acquire the control pursuant to the terms of an agreement in writing made by them on or before today's date. Corporations will also be able to elect to have the new rules apply to acquisitions of control that occur after 2005.

The Government will introduce legislation at an early opportunity.

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